No. 144

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

STATE BOARD OF INSURANCE, ET AL.,
Petitioners,

v.

TODD SHIPYARDS CORPORATION,
Respondent.

On Writ of Certiorari to the Court of Civil Appeals of Texas, Third Supreme Judicial District, Sitting in Austin, Texas

BRIEF FOR THE PETITIONERS

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BRIEF FOR THE PETITIONERS

The petitioners file this brief, and ask that the Court consider, in addition to this brief, the petitioners' Petition for Writ for Certiorari.

OPINION BELOW

The opinion of the District Court is unreported, and the judgment is printed in Appendix "B" in petitioners' Petition for Writ of Certiorari, pp. B-1—B-4. The opinion of the Court of Civil Appeals, printed in Appendix "C" in petitioners' Petition for Writ of Certiorari, pp. C-1—C-12, is reported in 340 S. W. 2d 339. The opinion of the Supreme Court of Texas in refusing to grant the petitioners' application for writ of error,

printed in Appendix "D" in petitioners' Petition for Writ of Certiorari, p. D-1, is reported in 343 S. W. 2d 241.

JURISDICTION

The judgment of the Court of Civil Appeals was entered on November 16, 1960. Rehearing was denied on November 23, 1960. The judgment of the Supreme Court of Texas refusing to grant the petitioners' application for writ of error was entered on February 8, 1961. Rehearing on petitioners' application for writ of error was refused on March 15, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., §1257(3). This Court granted the Petition for Writ of Certiorari on October 9, 1961.

QUESTION PRESENTED

Whether Texas is prohibited by the Due Process Clause of the Fourteenth Amendment of the United States Constitution from taxing insurance premiums paid by persons insuring Texas risks on insurance policies contracted for in New York.

STATUTE INVOLVED

The statutory provision involved is Section 2(e) of Article 21.38 of the Texas Insurance Code, Vol. 14, Vernon's Annotated Civil Statutes:

> "If any person, firm, association or corporation shall purchase from an insurer not licensed in the State of Texas a policy of insurance covering risks within this State in a manner other than through an insurance agent licensed as such under the laws of the State of Texas, such person, firm, association or corporation shall pay to the Board a tax of five per cent (5%) of the amount of the gross premiums paid by such insured for such insurance. Such tax shall be paid not later than thirty (30) days from the date on which such premium is paid to the unlicensed insurer."

STATEMENT

The facts were largely stipulated in the trial court, and will be here briefly summarized.

Article 21.38 of the Texas Insurance Code deals with the placing of insurance with unauthorized insurers. An "unauthorized insurer" is an insurance company not licensed to do business in Texas. Subsection (e) of Section 2 of that Article levies a 5% tax on the gross premiums paid by a purchaser of insurance covering risks located within Texas from an unauthorized insurer. Section 1 of Article 21.38 specifically states that its enactment is pursuant to the powers and privileges conferred upon the State by the McCarran Act, 15 U.S.C.A., § §1011-1015.

The respondent paid to the Comptroller of the State of Texas the tax levied by Section 2(e) of Article 21.38 of the Texas Insurance Code, under protest. Then the respondent filed suit in the 53rd District Court of Travis County, Texas, to recover the taxes paid, alleging that the tax was unconstitutional as a violation of the Due Process Clause of the Fourteenth Amendment of the United States Constitution. The trial court found the tax invalid as a violation of due process. On appeal, the Court of Civil Appeals, Third Supreme Judicial District, sustained the holding of the trial court upon the authority of *Allgeyer v. Louisiana*, 165 U.S. 528, (1896), and *St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 347 (1922). The Supreme Court of Texas refused the petitioners' application for writ of error, and its subsequent motion for rehearing, upon the authority of *Allgeyer v. Louisiana, supra*, and *St. Louis Cotton Compress Co. v. Arkansas, supra.*

The respondent is a New York corporation, licensed to do business in Texas, and, since 1934, has owned properties located at Galveston and Houston, Texas, of a

value exceeding $900,000.00 Approximately twenty-seven per cent (27%) of the respondent's volume of business is done in Texas, where it employs in the neighborhood of 1,500 persons. The principal activity of the respondent's Texas plants is the repair, conversion, and construction of ships, as well as the manufacture of industrial equipment and oil burners.

For protection of the respondent's property located in Texas, and for protection against risks arising out of the use of that property, the respondent purchases several types of insurance agreements, including:

(1) Industrial work property damage insurance (a liability insurance covering damage to property belonging to others undergoing repairs by the respondent);

(2) Builder's risk insurance (a liability insurance on vessels while undergoing repair or construction);

(3) Dry dock insurance (casualty insurance covering risks of dry docks);

(4) Pier and bulkhead collision insurance (casualty insurance covering damage to the piers and bulkheads caused by collision, flood, etc.);

(5) Product liability insurance, to the extent of the excess portion of that insurance (liability insurance covering claims for personal injury or property damage).

The respondent purchased this insurance from the Lloyds of London and The Institute of London Underwriters. Only insurance of these two companies is involved here, and each of these companies is domiciled in England. The respondent has purchased these types of insurance since 1934. This insurance was purchased for the respondent from the insurers by several New York and Canadian insurance brokers. None of these brokers is an insurance agent licensed under the laws of the State of Texas. The policies of insurance in question are

signed and issued by the insurers in England, and it is stated in the policies that the place of physical and actual issue and delivery of the policy is England, but, as between the insured and the insurer, the place of issuance may be considered New York City.

Neither of the insurers has a permit to write insurance in Texas, neither do they submit any statements of their condition to the State Board of Insurance, nor are the affairs of either in any way subject to examination by the Texas State Board of Insurance, nor does the State Board of Insurance have any control or supervision over their affairs. Neither of the insurers has an office or agent in the State of Texas. Neither insurer conducts any investigation of Texas claims in Texas; the adjustment of losses is handled between the respondent's agent in the New York office and the agent of the insurers in New York City. Neither of the insurers solicits the respondent's insurance business or policies within the State of Texas.

The Texas plants of the respondent do not correspond or conduct any negotiations with the insurers, but all negotiations are handled by the respondent's agent, in New York City, with the brokers of the insurer or directly with the London office. All decisions relative to the purchase of insurance and renewal of insurance, the extent and amount of coverage, the selection of insurers, and confirmation of insurance contracts are made at the respondent's New York office.

In the case of the builder's risk insurance, the Texas office of the respondent notifies the New York office that the respondent's Texas office has entered into a construction or repair contract. The New York office then applies to one of the New York insurance brokers for builder's risk insurance coverage on that particular vessel or contract; this application letter is signed by an officer of the New York office, but the coverage is re-

quested in the name of the Texas division and identifies Texas as the place where the work is to be performed.

When a loss occurs at the Texas plants of the respondent, that plant informs the New York office. The New York office then notifies the brokerage house that negotiated the insurance; the broker in turn appoints the London Salvage Association to prepare an estimate or "survey" of the loss. In some instances, the respondent's New York office notifies the London Salvage Association that a survey is requested. The Texas plant also appraises the amount of the loss. After appraisal, the London Salvage Association forwards its estimate or survey to the respondent's New York office, and the respondent then submits the survey to the particular insurance broker to be used in adjusting the amount of the loss. The Texas plant assists the London Salvage Association in arriving at a fair figure for the loss. The London Salvage Association issues a bill to the respondent for the London Salvage Association's services, and such a bill is paid in New York City by the respondent.

The adjusting of the loss is carried on by Lloyds through the insurance broker and the New York office. The insurance broker submits its adjustment figure and recommendation to the insurers for final approval. After the figure and adjustment of loss is approved, the New York office is notified by the insurance broker or the underwriter, and the New York office then notifies the Texas plants that the claim will or will not be paid.

FACTUAL SUMMARY

From a reading of the above statements, these factors appear:

(1) Todd is a foreign corporation, licensed to do business in Texas.

(2) The property insured by Todd is located in Texas.

(3) Todd purchased insurance on such property

with an insurance company not licensed to do business in Texas other than through a duly licensed agent.

The facts of this case come within the terms of Article 21.38, Section 2(e), Texas Insurance Code, and the only issue raised is the constitutionality of that provision.

ARGUMENT

WHETHER TEXAS IS PROHIBITED BY THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT OF THE UNITED STATES CONSTITUTION FROM TAXING INSURANCE PREMIUMS PAID BY PERSONS INSURING TEXAS RISKS ON INSURANCE POLICIES CONTRACTED FOR IN NEW YORK.

Despite the fulminations of the respondent to the contrary, there is little doubt but that this Court has cast aside the conceptualistic formulas of the *Allgeyer v. Louisiana*, 165 U.S. 528 (1896), and *St. Louis Cotton Compress Company v. Arkansas*, 260 U.S. 347 (1922), cases to decide a case of this nature. The Court now decides this kind of case according to the principles set out in *Osborn v. Ozlin*, 310 U.S. 53 (1940), *Hoopeston v. Cullen*, 318 U.S. 313 (1942). *Travelers Health Assoc. v. Virginia*, 339 U.S. 643 (1950), and *Watson v. Employers Liability Corp.*, 348 U.S. 66 (1956). These cases establish that the power of state regulation is no longer pretermitted by a conceptualistic test of the place of making a contract, but rather the test is one of determining the degree of interest in the insurance contracts by the regulating state. This argument is fully developed in the petitioners' petition for certiorari at pages 5-10, and will not be repeated here.

At this point, it becomes necessary to examine Article 21.38, its purpose and effect. The primary purpose of Article 21.38 is to regulate the placing of insurance

by resident insureds with unauthorized insurers on risks located in Texas. That purpose appears in Section 1. "The Legislature declares that it is the subject of concern that the placing of such direct line of insurance with unauthorized insurers is not properly regulated. . . ." This regulation is effected by a tax levied upon insureds purchasing insurance from unauthorized insurers on Texas risks.

Subsections (a), (b), and (c) of Section 2 provide for licensing of agents to sell insurance of unauthorized companies to insurers who are unable to secure from licensed companies the full amount of coverage necessary for a particular risk. The agent pays a five per cent (5%) tax on the gross premiums paid for such insurance placed through him in unauthorized insurers.

In 1957, subsection (e), the constitutionality of which is questioned in this lawsuit, was added to Section 2 and provided that if an insured purchased insurance from an unauthorized company other than through a licensed agent the insured must pay a five per cent (5%) tax of the gross premiums so paid.

Subsection (e) is concerned with the owners of *Texas* risks purchasing insurance from unauthorized insurers. And it confines itself to unauthorized insurers, i.e., insurers who are not licensed to do business in Texas, which could be insurance companies incorporated in other countries, those incorporated in other states in this country, or those incorporated in this State but which have not complied with the Texas law. Subsection (e) levies a tax upon the insured buying insurance for property or risks in Texas, so it is apparent that the tax is *not* placed on the *unauthorized insurer*.

What is the regulatory effect of the tax? Before this question can be answered adequately, it is necessary to briefly examine the background of insurance regulation in Texas and its general purposes.

The pre-regulated era in Texas insurance history is unfortunately well known. See Texas Insurance Code, Vol. 14, Vernon's Annotated Civil Statutes, pp. XXIII-LIX. At that time, many foreign and domestic companies used every technical device and, at times, resorted to trickery and fraud to defeat paying bona fide claims. Most insurance companies were under-financed, causing frequent failures. There also existed discriminatory rate practices, especially in fire insurance.

In 1876, the Legislature created a Department of Insurance and over the years has greatly increased its authority over the insurance business. Presently, the State Board of Insurance, as it is now called, is charged with the enforcement of laws and promulgation of policy which comprehend practically every phase of the insurance business. Illustrative of the requirements of the Texas Insurance Code are the following: the maintenance of minimum capital and minimum surplus, Article 2.02; that annual financial statements be submitted to the State Board of Insurance, Article 6.11, Article 8.07, etc.; that examinations be made of insurance companies doing business in Texas, Article 1.15; that certain reserves be maintained, Article 1.10; that high caliber investments be maintained, Article 2.10; that policy forms be approved by the State Board of Insurance, Chapter 5; that the insurance companies file a bond conditioned that the company will pay its lawful obligations, Article 6.09; and that in certain types of insurance the State Board of Insurance set rates, Chapter 5.

Although prior to the enactment of Article 21.28 the Legislature had enacted comprehensive measures designed to regulate, control, and supervise the insurance business so as to protect resident insureds, the problem of unauthorized insurers remained to be solved. These unauthorized insurers sold insurance to the owners of risks located in Texas, and these insurers in no way were regulated by the State Insurance Department.

Such a hiatus severly weakened the State regulatory scheme. The worth of such a policy varied with the solvency of the unauthorized company. Some of the unauthorized companies were, and are, subjected to little or no state regulation or supervision. As long as this hiatus existed, the effectiveness of the Texas regulatory program was crippled.

Then, returning to the question, what is the regulatory effect of the tax levied by subsection (e), the simple effect of the tax is to reduce the number of owners of Texas risks who purchase insurance from unauthorized companies by making it more expensive to do business with unauthorized insurance companies. Subsection (e) does not forbid owners of property or risks to place insurance with unauthorized companies, but requires those who do so to pay a five per cent (5%) tax on the gross premiums. The Legislature has determined by various laws that Texas risks can be best protected by insuring those with controlled and supervised insurance companies, i.e., authorized companies. Subsection (e) attempts to accomplish this end by means of a tax. It has long been recognized that taxation may be made the implement of the exercise of the State's police power. See *Great Atlantic and Pacific Tea Co. v. Grosgean*, 301 U.S. 412 (1937).

Since the validity of subsection (e) must be determined by the degree of interest of Texas in the insurance contracts, it is then important to examine the interest of Texas in this insurance, *Osborn v. Ozlin, supra, Hoopeston v. Cullen, supra, Travelers Health Assoc. v. Virginia, supra*; and *Watson v. Employers Liability Corp., supra.*

It is at once apparent that this interest is substantial. Most important in these considerations is the fact that the insured respondent is a Texas resident and the property and risks insured are physically located in Texas. The respondent began its operations at Galveston and

Houston in 1934 and has invested over $900,000.00 in its plants and equipment in Texas. The states have long exercised powers over property located within their respective jurisdictions, *Hoopeston v. Cullen.*[1]

The inability or failure of the unauthorized insurance company to pay large casualty losses of the insured could cause catastrophic economic consequences in the Galveston and Houston areas. The labor force of the respondent of some 1,500 persons would be unemployed. Until reemployed the State would be called upon to provide relief for these people. *Alaska Packers Ass'n v. Industrial Accident Comm. of California, et al,* 294 U.S. 532 (1935).[2] The loss of the purchasing power of this group would affect adversely the local business community. Both the

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[1] "A state may make flood control, quarantine, conservation and zoning regulations affecting the property within its bounds. It is a source of law for the forms of conveyances, the nature of covenants, future interest and easements, for the construction of wills, trusts and mortgages, and for many other legal principles affecting property interests. Contracts made in other states may remain subject to the law of the state of the situs of the property, particularly in respect to immovables. *There is no more reason to bar the state from authority over the insurance of the property within it than to exclude it from control of all the property interests mentioned.*" id, at page 318 (Emphasis added.)

[2] (at page 542) "The meagre facts disclosed by the record suggest a practice of employing workers in California for seasonal occupation in Alaska, under such conditions as to make it improbable that the employees injured in the course of their employment in Alaska would be able to apply for compensation there. It was necessary for them to return to California in order to receive their full wages. They would be accompanied by their fellow workers, who would normally be the witnesses required to establish the fact of the injury and its nature. The probability is slight that injured workmen, once returned to California, would be able to retrace their steps to Alaska, and there successfully prosecute their claims for compensation. *Without a remedy in California, they would be remediless, and there was the danger that they might become public charges, both matters of grave public concern to the state.*" (Emphasis added.)

sales and ad valorem tax collections would be reduced. Presumably, the paucity of facilities like that of the respondent would adversely affect the volume of maritime activity at Galveston and Houston, with widespread deleterious economic consequences to the whole community.

The events which give rise to the contractual obligations of the unauthorized insurance company to pay on policies will occur in Texas, and Texas provides the judicial machinery for the adjudication of these rights. Texas or its instrumentalities extend police protection to the insured property, and, especially in cases of losses by the insured, the State will be called upon for additional police protection. The State and its instrumentalities provide an orderly frame within which the respondent may conduct its affairs as well as provide services essential to its economic well-being, such as street, harbor, and channel construction and maintenance.

In case of some of the insurance involved, persons compensated will be residents of Texas, and upon them will be placed the task of bringing suit in the event the unauthorized insurer denies the risk. These people will be treated in Texas hospitals by Texas doctors. As they may be destitute, they may be compelled to call upon individuals or the State for aid. *Watson v. Employers Liability Corp., supra.*[3] These persons will more than

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[3] (at page 72) "Louisiana's direct action statute is not a mere intermeddling in affairs beyond her boundaries which are no concern of hers. Persons injured or killed in Louisiana are most likely to be Louisiana residents, and even if not, Louisiana may have to care for them. Serious injuries may require treatment in Louisiana homes or hospitals by Louisiana doctors. The injured may be destitute. They may be compelled to call upon friends, relatives, or the public for help. Louisiana has manifested its natural interest in the injured by providing remedies for recovery of damages. It has a similar interest in policies of insurance which are designed to assure ultimate payment of such damages. Moreover, Louisiana courts in most instances pro-

likely resort to Texas courts, and, unless they do, they will have to resort to distant forums at great trouble and expense.

Texas has a vital interest in the effective enforcement of the laws regulating insurance on risks located in Texas. As noted by the Court of Civil Appeals, below, the insurance business has become rigidly regulated by the State to control the irresponsibility of the insurance business. This was done to protect the owners of Texas risks from investing in contracts of insurance of companies which had not established their responsibility, financially or otherwise. However, many Texas residents were not protected by the regulatory laws of the State since they were sold insurance on Texas risks from insurance companies not submitting to the regulatory supervision of the State. Such unauthorized companies in no way subjected themselves to the supervision and control of the State Board of Insurance. As long as this gap existed, the protection afforded by the State to its residents by its regulatory insurance program was limited.

A part of the Texas regulatory scheme is fixing of fire insurance rates by the State Board of Insurance. The rate of a particular area is determined in part by the loss experience reported to the State Board of Insurance. If, over a period of time, there has been no fire

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vide the most convenient forum for trial of these cases. But modern transportation and business methods have made it more difficult to serve process on wrongdoers who live or do business in other states. In this case efforts to serve the Gillette Company were answered by a motion to dismiss on the ground that Gillette had no Louisiana agent on whom process could be served. If this motion is granted, Mrs. Watson, but for the direct action law, could not get her case tried without going to Massachusetts or Illinois although she lives in Louisiana and her claim is for injuries from a product bought and used there. What has been said is enough to show Louisiana's legitimate interest in safeguarding the rights of persons injured there. . . ."

experience, the rate of the area is credited. However, an unauthorized insurer does not report its experience, and, consequently, within a given area, the fire rates may be entirely too low for the actual experience of the community. The rate for individual risks may be reduced by the State Board of Insurance if the hazards surrounding the risk are reduced by the insured. Such reduction in rates provides an incentive to reduce fire hazards, which acts for the community good. However, the State Board of Insurance has no authority to reduce the rates of unauthorized insurers, and, thus, if the insurer will not voluntarily reduce its rates, the insured will have no incentive to reduce its fire hazards. (See Articles 5.25 and 5.33 which clearly point out that one of the purposes of rate regulation in Texas is to encourage the reduction of the hazards of fire).

One of the purposes of fire insurance rate regulation is to prevent discrimination in rates by insurers as between insureds. See Article 5.41, Texas Insurance Code. Certainly, the insuring with unauthorized companies of Texas risks thwarts the intent of the statute since the unauthorized insurer may vary its rate among similarly situated insureds as much as it pleases.

Prior to subsection (e) of Section 2, subsections (a), (b), (c), and (d) of Section 2, Article 21.38 provided at least a measure of control over unauthorized insurers placing insurance in this State. The licensed agent was required to report to the State Board each sale of unauthorized insurance. In this manner, the State Board was kept apprised of the unauthorized insurance in Texas, and could at least circulate information over the State about the reliability of the unauthorized insurer concerned. However, most of the insureds who obtained insurance with unauthorized insurers did not bother to buy this insurance through licensed agents. To help secure compliance with subsections (a), (b), (c), and (d), the

Legislature enacted subsection (e). See *Osborn v. Ozlin*, 310 U.S. 53 (1940), p. 63.

Another vital interest of Texas is that as the regulation of insurance in Texas is designed to protect persons buying insurance on risks within Texas, it is proper that all of these risks share equally the cost of this regulation. The tax levied by Article 21.38, Section 2(e), was enacted to equalize the tax burden born by Texas risks.[4] Before the enactment of Section 2(e), authorized insurance companies paid the entire tax load for the regulatory supervision of the insurance industry in Texas as a consequence of insuring Texas risks, while the Texas risks insured against by unauthorized insurance companies escaped from paying any taxes. If Section 2(e) is invalidated, the authorized insurance companies will once again shoulder the entire burden of paying for the regulation of insurance in Texas. And again the temptation would be strong for companies, now submitting to the supervision and control of the State Board of Insurance, to abandon compliance with Texas law and begin underground insurance writing outside the State, as unauthorized insurers.

More than the interests of Texas and the respondent are involved here. The whole future of state regulation of the insurance business hangs in the balance. Some twenty-two states have provisions similar to that of

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[4]Article 7064, Vernon's Annotated Civil Statutes, levies a 3.85% premium tax on all authorized insurance companies in addition to the various maintenance taxes: The Fire Insurance Maintenance Tax (Art. 5.49, Texas Insurance Code); The Casualty Insurance Maintenance Tax (Art. 5.24, Texas Insurance Code); and the Workmen's Compensation Insurance Comm. Tax. (Art. 5.68, Texas Insurance Code). [The above cited Articles appear in Vol. 14, Vernon's Annotated Civil Statutes.] These taxes alone aggregate 5% or more of the gross premiums, the amount levied by Section 2(e), charged and do not take in account various agency fees and filing fees paid by authorized insurers.

Texas. See Appendix "E" of Petition for Writ of Certiorari. Some insureds, like the respondent, already purchase insurance from unauthorized insurers while literally hundreds of other large, multi-state insureds are waiting in the wings to see whether subsection (e) falls. If it does, they will shift their insurance to unauthorized companies. The companies now licensed in Texas will not be blind to the fact that it would no longer be necessary to submit to Texas regulation to secure Texas business, and the State will witness an exodus of insurance companies. Then the bulk of the insureds purchasing insurance from the regulated companies will be those too small and uninformed to purchase from unauthorized insurers. On these insureds will ultimately fall most of the cost of regulation of insurance. Also, many of the very largest risks will be insured in companies over which the State has utterly no control.

Respondent may argue that State protection is unnecessary for large multi-state insureds who are in a position to protect their own interests; however, if the loophole is open, then small insureds not able to protect themselves will also purchase unauthorized insurance. The regulatory scheme as a whole is well-suited to protect against these evils as pointed out in the *Osborn* case. Here, as in *Osborn v. Ozlin*, this legislation is not to be judged by abstracting these insurance contracts written in New York from the organic whole of the insurance business, the effect of that business on Texas, and Texas' regulation of it.

The petitioners submit that these interests of Texas in the insurance contracts involved here are every bit as substantial, or more substantial, than those involved in *Osborn v. Ozlin*, *Hoopeston v. Cullen*, *Travelers Health Association v. Virginia*, and *Watson v. Employers Liability Corp.*, *supra*.

In conclusion, the petitioners submit that the Court

of Civil Appeals, below, was in error in resolving this case by a due process philosophy, *Allgeyer v. Louisiana*, which has been deliberately discarded by the United States Supreme Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

A copy of this Brief for the Petitioners has been served pursuant to Supreme Court Rule No. 33 by depositing a copy of the Brief in a United States Mail Box, with first class postage prepaid, addressed to counsel of record for the Respondent at his Post Office Address, 510 Gulf Building, Houston 2, Texas.

Bob E. Shannon

BOB E. SHANNON